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IN THE

# Supreme Court of the United States.

OCTOBER TERM, 1942.

No. 135

SECOND CAREY TRUST, AN EXPRESS TRUST,
*Petitioner,*
*v.*
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

This is a petition for a writ of certiorari to the United States Court of Appeals for the District of Columbia, involving a decision by that Court in the case of *Second Carey Trust, an Express Trust*, v. *Helvering, et al.*, No. 7,865, wherein that Court affirmed a holding of the United States Board of Tax Appeals.

## OPINIONS BELOW.

The opinion of the Court of Appeals (R. 95–101) is reported at —— App. D. C. ——, 126 F. (2d) 526, and the opinion of the Board of Tax Appeals (R. 15–34) is reported at 41 B.T.A. 800.

## JURISDICTION.

The opinion of the United States Court of Appeals for the District of Columbia was entered March 9, 1942 (R. 95–101), and the judgment of the Court was entered on the same day (R. 102). This petition is made pursuant to Section

240(a) of the Judicial Code (36 Stat. 1157, Sec. 240(a)), as amended by the Act of February 13, 1925 (43 Stat. 938; 28 U.S.C.A. Sec. 347), and within the three months period from the date of entry of judgment in the lower Court as provided by Section 8 of the Act of February 13, 1925, c. 229 (43 Stat. 940, 28 U.S.C.A. Sec. 350).

## STATUTES INVOLVED.

The relevant statutes are set out in the appendix to this petition (pp. 19–22).

## SUMMARY STATEMENT OF THE MATTER INVOLVED.

On January 19, 1934, A. J. Diffie, W. E. Brown, and H. I. Shanks executed a "Formation and Declaration of Trust" (R. 73–84) in which they designated themselves trustees of an interest consisting of the right to receive one-eighth of seven-eighths of the net proceeds from the sale of oil and gas produced from the Westgate-Carey oil and gas mining lease. The trust was named "Second Carey Trust" and was organized as an "express trust" under Sections 11,820–23 of the Oklahoma Statutes of 1931 (App. 21–22), with office at 905 Kennedy Building, Tulsa, Oklahoma. (R. 62–64, 73, 76.)

The trustees also declared as property of the trust four non-producing oil leases. Said leases were never developed or operated and never produced any revenue. They expired twelve months from their date because of non-payment of rental. (R. 64, 66.)

The material provisions of the trust instrument were as follows:

That the trust estate should be represented by 5,000 units of beneficial interest for which non-assessable certificates of beneficial interest were to be sold, each unit of beneficial interest entitling the owner thereof to a one five-thousandth part of the net income and proceeds derived from the trust estate (R. 77); that said certificates should be transferable

only upon the books of the trust (R. 77); that the trustees should have exclusive power and authority to manage the trust, to receive and collect the income from the trust property, to distribute the income and proceeds therefrom, and to sell and convey any of the trust property with the written consent of the owners of two-thirds of the beneficial units (R. 78); that the trustees were authorized to deduct from the gross receipts all necessary expenses incurred in connection with the management and administration of the trust, including as compensation for themselves five percent of the net receipts from whatever source derived (R. 79) and were required to distribute the net receipts so arrived at equally among the unit holders before the 25th day of the month following the month in which such receipts were received, less a small amount which might be necessary to defray current expenses (R. 80); that neither the trustees nor the unit holders should be personally liable for the obligations of the trust and that the death of a unit owner or the transfer of a unit should not affect the continuity of the trust (R. 81); that the trust should exist for a period of 20 years, but could be terminated at any time upon the written direction of the owners of two-thirds of the beneficial units (R. 78); that the trustees should administer the trust faithfully and diligently and should keep correct records and accounts of all transactions (R. 82); and that, upon the resignation of any trustee, the remaining trustees should name his successor (R. 83).

The trustees sold the 5,000 units of beneficial interest to the public for the sum of $500,000. The expense of selling the units was $100,000 and $400,000 was applied to pay for the interest in the Westgate-Carey lease. (R. 63–64.)

On January 19, 1934, the Westgate-Carey lease was a producing lease and was being operated by the Westgate Oil Company under an agreement with Natural Gas Corporation made prior to January 19, 1934. Petitioner had a minority interest in the lease and had no voice in its management or operation. Its only right was to receive its share of the pro-

ceeds from sales of oil and gas, less its share of the operating expenses. (R. 62–63, 65–66.)

Petitioner has never operated any oil property (R. 64). Its only activity has been the receipt of the net proceeds to which it was entitled and distribution of those funds to its certificate holders (R. 62–63). Petitioner was not consulted as to the operation and management of the Westgate-Carey lease (R. 66). Petitioner has never purchased or invested in any other property or sold any of the property which it owned (R. 24, 64). It has never owned an interest in well drilling and development machinery. It acquired a pro-rata interest in the Westgate-Carey lease operating equipment and through the withholding of its share of the operating expenses by the company operating the lease, petitioner has acquired a pro-rata share in the additions to the lease operating equipment. (R. 24, 63.)

Petitioner filed an income tax return for 1934 as a trust on Form 1040, disclosing therein a net loss for the year. Respondent determined that petitioner was an association, taxable as a corporation. The Board, one member dissenting, and the lower Court affirmed this holding. (R. 10, 29, 34, 99.)

Petitioner's trustees did not own any units of beneficial interest in the trust and had no interest in the trust property; except that they retained for themselves the proportionate part of the net income from the Westgate-Carey lease which was apportionable to the unsold units of beneficial interest (R. 77, Par. Fifth). While the beneficial units were being sold in 1934, the net income applying to unsold units was $48,382.84. The trustees retained only $11,500.00 of this amount and contributed the balance of $36,882.84 to the trust. Said amount did not constitute income to petitioner, but respondent included the amount in petitioner's income for 1934. (R. 68, 91.) The Board questioned whether the amount constituted income but refused any relief on the ground that the issue was not raised in the petition, and the Court of Appeals affirmed. (R. 33–34, 101.) The issue was raised in the petition before the Board in Paragraph 4(b)

(R. 4), which alleges error in treating all cash receipts of the trust as income, regardless of their source.

In its 1934 return petitioner took a deduction for depreciation and depletion in the amount of $35,466.05, based upon cost. The revenue agent was furnished the data to substantiate these deductions but he recommended that no deductions be allowed, not because they were not proper, but because petitioner had not *filed* the substantiating data with the Bureau of Internal Revenue, when advised by its then counsel that to do so might be taken as an admission that it was an association taxable as a corporation. The respondent did not allow any deduction against income to petitioner for depreciation and depletion. (R. 11, 12, 25, 69–70, 90.) The statute provides that a deduction for depletion shall be allowed on the cost or percentage basis, whichever gives the greater deduction. (App. 20, *infra*.) The Board held it was improper to allow no deduction and it allowed a depletion deduction on the percentage basis (27½% of gross income from the property), but did not allow deductions for depreciation and depletion on the basis of cost (which exceed percentage depletion) because of lack of evidence. The Court of Appeals did not allow any further deductions. (R. 30, 31, 100–101.)

Petitioner was required to pay its share of the development expenses on the Westgate-Carey lease in 1934. It did not deduct these expenses in its 1934 return because the return was filed upon the trust basis and showed a loss without the deduction. Respondent did not allow the development expenses on the ground that petitioner failed to elect to deduct them. The Court below did not allow the deduction on the ground that the issue was not raised in the pleadings. (R. 47, 52, 93, 101.)

At the hearing before the Board petitioner's then counsel introduced evidence relating to the formation of the petitioner and the type of activity in which it engaged, in an effort to show that it should be taxed as a trust. He also introduced evidence to show that respondent arbitrarily and erroneously failed to compute properly petitioner's income and tax, even

if petitioner should be held to be taxable as a corporation. (R. 60–72.) He did not prove the proper income and deductions, but proceeded on the theory that petitioner's taxable status would be resolved before other questions became material. Acting on this premise, at the conclusion of the hearing he filed a motion for a further hearing in order to show the correct amount of tax due, if the Board should hold petitioner taxable as a corporation and should find the Commissioner's determination arbitrary, excessive, and erroneous. (R. 14.) The Board held that petitioner was taxable as a corporation and that the respondent's determination was excessive and erroneous in certain respects, but it did not grant a further hearing for the purpose of determining the correct tax liability. (R. 29–30.) Thereafter the Board denied timely motion for rehearing, reconsideration and further hearing (R. 34–39); and a motion to vacate decision, for new trial or further hearing, for additional findings, and to allow amendments to petition with regard to the elimination of $36,882.84 from income and a deduction for development expenses. The requested additional findings and amendments were attached. (R. 40–53.) The lower Court refused to direct a rehearing for the purpose of arriving at the correct tax liability. (R. 99–101.)

Petitioner desires this Court to review the case and decide the question of (1) whether the trust is an association taxable as a corporation; (2) whether the amount of $36,882.84 contributed to the trust was income; and (3), if it is held that petitioner is taxable as a corporation, whether the case should be remanded for rehearing in order to determine petitioner's correct income and tax liability in 1934, including the proper deductions for depreciation, depletion, and development expenses.

## QUESTIONS PRESENTED.

The questions presented are:

1. Is petitioner a trust and taxable as a trust, or is it an association taxable as a corporation?

2. Should the amount of $36,882.84 be excluded from petitioner's income, when it was a gift and a contribution to the corpus of the trust?

3. Even if petitioner is an association taxable as a corporation, should the case be remanded to the Board, under the circumstances of this case, to determine petitioner's correct tax liability with particular reference to allowable depreciation and depletion deductions and deduction of development expenses?

## REASONS RELIED UPON FOR ALLOWANCE OF WRIT.

1. The decision of the lower Court that petitioner's status as an express trust under the laws of Oklahoma is not binding for taxation purposes, conflicts with the decision of this Court in *U. S.* v. *Cambridge Loan & Bldg. Co.*, 278 U. S. 55. There this Court held that where the income tax act did not define a "building and loan association" (exempted from taxation by the act), the question of whether the taxpayer was a building and loan association must be determined under State law. Here the Revenue Act taxes "associations" as corporations but does not define what an "association" is. Petitioner's status under Oklahoma law must therefore govern its status for Federal tax purposes. Under Oklahoma law, an express trust is held not to be an association taxable as a corporation. *State* v. *Prairie Cotton Oil Co.*, 180 Okla. 608, 71 P. (2d) 988.

2. The decision of the lower Court that petitioner is an association taxable as a corporation is in conflict with the decisions of this Court in *Crocker* v. *Malley*, 249 U. S. 223, *Morrissey* v. *Com.*, 296 U. S. 344, and *Helvering* v. *Combs, et al.* 296 U. S. 365. In those cases this Court held that the essentials of taxability as a corporation include association in an enterprise

for the transaction of business. As appears from the foregoing statement, the owners of the units of petitioner's beneficial interests were not associated together; the certificates were sold to members of the public who did not know the other certificate holders and had nothing to do with the planning or creation of the trust. They did not carry on a business since their only activity was to receive their proportionate share of the net proceeds from the lease.

3. The decision of the lower Court that petitioner was carrying on a business is in conflict with the decisions of this Court in *Higgins* v. *Com.*, 312 U. S. 212; *City Bank Farmers Trust Co* v. *Helvering*, 313 U. S. 121; and with the decision of the Circuit Court of Appeals, Sixth Circuit, in *The Cleveland Trust Co.* v. *Com.*, 115 F. (2d) 481. In those cases it was held that the mere receipt and recording or distribution of income does not as a matter of law constitute doing business. The petitioner's activities during the taxable year were the collection of its share of the net proceeds from the Westgate-Carey lease and the distribution of it to the holders of beneficial interests. The trust instrument required the trustees to distribute the income monthly (R. 80), and gave them no power to hold, reinvest or otherwise dispose of it. The lower Court held (R. 99) that the decision to abandon four non-producing leases was evidence of carrying on business. The Court misconceived the facts. The record shows that petitioner never paid rent on the leases and they expired without having been developed at the end of 12 months from the date of the lease for failure to pay rental. (R. 66.) The trustees had no power to develop the leases, since they were required to distribute all income, and no power to sell without the consent of two-thirds of the beneficial owners. The non-payment of rent certainly can not be considered the doing of business under the aforesaid decisions of this Court, and it is difficult to see how business can be carried on by a decision not to pay rent on undeveloped leases.

4. The refusal of the lower Court to exclude the amount of

$36,882.84 from petitioner's income conflicts with the decision of the Circuit Court of Appeals, First Circuit, in *Rice, Barton & Fales, Inc.*, v. *Com.*, 41 F. (2d) 339, and with that of the Circuit Court of Appeals, Seventh Circuit, in *American Dental Company* v. *Com.*, ——— F. (2d) ———, decided May 15, 1942. The said amount was contributed by the trustees to petitioner without obligation on their part to do so. Under the aforesaid decisions amounts so contributed constitute gifts and are not income (Sec. 22(b) (3), App. 19). The Court's statement that the issue was not raised by the pleadings is clearly erroneous when the issue is comprehended within the allegation that respondent erred in holding all cash receipts to be income, regardless of the source from which derived (R. 4).

5. The lower Court *assumed without proof* (R. 101) that the petitioner's trustees "disregarded" the amount of $36,882.84, which they contributed to the trust, as income upon which they were taxable, and refused to exclude the item from petitioner's income in part on this ground. The trust composed of its beneficiaries is a different entity from the trustees (none of whom were beneficiaries), and it is erroneous to consider their tax liabilities as a unit. Moreover, the revenue agent's report dated August 1, 1936 (R. 91), discussed the item long before the statute of limitations barred assessment against the trustees. If the trustees did not report the amount as income, it may be assumed that an assessment of tax based on the amount was made at that time. It should be observed also that the lower Court made the assumption, that the trustees did not report the amount of $36,882.84 as income, of its own volition and without a suggestion from either party that such might be the fact.

6. The refusal of the lower Court to order a rehearing for further evidence conflicts with decisions of the Circuit Court of Appeals, Fourth Circuit, in *Underwood* v. *Com.*, 56 F. (2d) 67, and the Circuit Court of Appeals, Sixth Circuit, in *Ray W. Torrey Co.* v. *Com.*, 84 F. (2d) 659. In those cases it was

held that where it appears that the income and tax liability as found by the Commissioner or the Board is obviously wrong, it is the *duty* of the Board and the Court to order a rehearing. In the *Underwood* case, the question was whether the salary of a State architect was exempt from taxation, and if not exempt, the amount of his net income. At the hearing the taxpayer failed to prove the deductions to which he was entitled in arriving at net income. The Board held that his salary was not exempt and held all of it to be taxable because of lack of proof as to the allowable deductions. The Circuit Court reversed because the income and tax liability, as determined, were clearly wrong. In this case the evidence establishes that the income and the tax determined to be due thereon for 1934 were excessive, and the Board's opinion shows that petitioner was entitled to additional deductions. This is not a case where the taxpayer merely failed in his proof. Here no proof of correct income and deductions on the corporate basis was offered, due to the theory of procedure held by petitioner's original attorney at the hearing. The Board was requested at three different times, by timely motions, to correct the error and order a rehearing (R. 14, 34, 40). A more complete argument of this point appears in the motion to vacate (R. 40–53).

## CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the petition for writ of certiorari should be granted.

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## MEMORANDUM IN SUPPORT OF FIRST, SECOND, AND THIRD REASONS FOR GRANTING WRIT OF CERTIORARI.

This memorandum in lieu of a full brief, is submitted to the Court in support of the first, second, and third reasons for allowance of the writ of certiorari.

*First Reason:*

The provisions of the Revenue Act of 1934 for the taxing of trusts are found in Sections 161(a) and 162(b) (App. 20) which provide that the taxes imposed on individuals shall apply to the income of property held in trust; that the trust income shall be "computed in the same manner and on the same basis as in the case of an individual" and that any amount of income which is to be distributed currently to the beneficiaries shall be allowed as a deduction in computing the income of the trust.

The facts in this case establish that petitioner is a trust created under Oklahoma law and that its property is held in trust by its trustees for the benefit of its beneficial owners. The trust instrument provides that all moneys received from trust properties (income or capital) shall be distributed to the beneficiaries on or before the 25th day of the month following the month in which received (R. 80).

Thus petitioner comes squarely under the law imposing a tax on trusts. Its property is held in trust and it distributes its income monthly, as well as the proceeds from its capital (depreciation and depletion reserves). The Board and the Court, however, held that petitioner is an association taxable as a corporation under Section 801 (a) (2) of the Act. In so doing they disregarded the fact that petitioner is an express trust and is not an association under Oklahoma law.

In *U. S.* v. *Cambridge Loan and Bldg. Co.*, 278 U. S. 55, the question was whether the Cambridge Company was a building and loan association within the meaning of the revenue act exempting such associations from taxation. The United States contended that the company was for all practical pur-

poses a bank. It was held in an opinion by Mr. Justice Holmes that, since the Federal law did not define a building and loan association, the company's status under Ohio law must determine the question. Since it was recognized as a building and loan association in Ohio, it must be so recognized for Federal tax purposes.

Section 801(a) (2) of the Revenue Act of 1934 defines the term "corporation" as including associations, but nowhere does the Act define the word "association." Therefore, applying the *Cambridge Loan & Building Company* decision, it is necessary to look to Oklahoma law to determine petitioner's status. There petitioner is not an association taxable as a corporation.

Petitioner is an "express trust" organized under Sections 11,820–11,823, inclusive, of the Oklahoma Statutes, 1931 (App. 21–22). These sections authorize the creation of express trusts for certain purposes and establish them as entities under Oklahoma law.

By Section 11,820 trustees of express trusts are authorized to do only acts which individuals, as distinguished from corporations, may do. It has been so held by the Oklahoma Supreme Court and an "express trust" is treated as an individual. See *General American Oil Co.* v. *Wagoner Oil & Gas Co.*, 118 Okla. 183, 247 Pac. 99; *Wagoner Oil & Gas Co.* v. *Marlow*, 137 Okla. 116, 278 Pac. 294; *State ex rel.* v. *Douglass*, 185 Okla. 3 (found in dissenting opinion); *New York Casualty Co.* v. *Day*, 185 Okla. 581.

In *State* v. *Prairie Cotton Oil Company* (1937), 180 Okla. 608, 71 Pac. (2d) 988, the State of Oklahoma had taxed the Prairie Company, an express trust, as a corporation under Section 12,369, Oklahoma Statutes, 1931, which provided in part:

> "All corporations organized, existing, or doing business in this state, for profit, other than public service corporations * * *, and other than national banks, state banks, and trust companies, shall be assessed upon the value of their moneyed capital," etc.

The Court, in holding that the company was not a corporation, said:

"The defendant in the instant case is a business trust organized pursuant to Sections 11,820–11,823, Oklahoma Statutes, 1931. It is not a corporation, company, association or joint stock company having powers not possessed by an individual within the purview of Sections 1 and 18B, Article IX, of the Constitution, and is, therefore, not a corporation within the meaning of the tax statutes, Sections 12,369, 12,372, Oklahoma Statutes, 1931. The evidence shows that its affairs are conducted by 3 trustees who employ a manager subject to their own supervision. The trustees are subservient to no one. It is therefore not a joint stock company. *Earlsboro Gas Co.* v. *Brown Drilling Co.*, 175 Okla. 320, 52 Pac. (2d) 730. Aside from the fact that it has a trade name in which it may sue or be sued, it has no rights under the law that an individual does not possess. See *Liquid Carbonic Co.* v. *Sullivan*, 103 Okla. 78, 229 Pac. 561. That fact alone is insufficient to warrant its classification as a corporation. Its property is assessable for taxation in the same manner as that of any individual."

It is thus conclusively shown that under Oklahoma law, an express trust is not an association and is not taxable as a corporation. It is an individual, whereas an association is placed in a class with corporations. In line with the *Cambridge Loan & Bldg. Company* and other decisions of this Court, *e. g.* regarding the status of spouses in the community property states,* the petitioner's status under State law determines its taxable status under the Federal revenue act to be that of a trust.

*Second and Third Reasons:*

Section 801 (a) (2) provides that the term "corporation" shall include associations. The Board and the Court held that petitioner was an association. Petitioner contends that it was not an association, under applicable decisions of this Court, even though the Oklahoma law is held not to control its status.

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* *Poe* v. *Seaborn*, 282 U. S. 101; *Goodell* v. *Koch*, 282 U. S. 118; *Hopkins* v. *Bacon*, 282 U. S. 122; *Bender* v. *Pfaff*, 282 U. S. 127.

In 1919 this Court decided *Crocker* v. *Malley*, 249 U. S. 223. That case arose under the Income Tax Act of 1913, which taxed "every corporation, joint-stock company or association." There the trust owned paper manufacturing mills which were being operated by lessees. The function of the trustees was to collect the rents and income from the property, but they had broad discretion in handling the trust's affairs. They were required to handle the property and income for the benefit of the beneficiaries, but were not required to make annual distributions and could in fact reinvest the funds and postpone distribution for a period of 20 years, the term of the trust. The Court, speaking through Mr. Justice Holmes, held that the trust was not an association taxable as a corporation. The Court said:

> "There can be little doubt that in Massachusetts this arrangement would be held to create a trust and nothing more. 'The certificate holders * * * are in no way associated together * * *.'
> * * * * * * * * *
> "We perceive no ground for grouping the two—beneficiaries and trustees—together, in order to turn them into an association, by uniting their contrasted functions and powers, although they are in no proper sense associated. It seems to be an unnatural perversion of a well-known institution of law."

The trust in the *Crocker* case had broader powers than did petitioner. It could re-invest its funds and petitioner's trustees could not. It could accumulate indefinitely while petitioner had to distribute its funds monthly. The beneficiaries could change the compensation of the trustees and designate the successors in the case of a vacancy. No such powers existed in the beneficiaries of petitioner. The language of the Court there clearly indicates a recognition of the State's inherent right to control property rights and determine the legal status of its subjects for tax purposes in the absence of a clear intention in the law to classify them otherwise. The *Crocker* decision goes much farther than this Court is asked to go in the instant case.

In 1924 the Supreme Court decided the case of *Hecht* v. *Malley*, 265 U. S. 144, and three associated cases. All four cases involved trusts and the question was whether or not they were engaged in business so as to subject them to the excise tax provision (commonly called the capital stock tax law) of the Revenue Act of 1918. The law taxed corporations and associations alike upon the value of their capital stock if they were engaged in carrying on or doing business. The Court found that all four trusts were engaged in business and therefore were subject to the tax. One of the trusts was the trust involved in the *Crocker* case, *supra*, but the Court pointed out that it had been changed or reorganized so that it was now clearly engaged in business.

The last important decision of the Court on the taxing of trusts as corporations is *Morrissey* v. *Commissioner of Internal Revenue*, 296 U. S. 344, and associated cases. That case arose under the income tax provisions of the Revenue Acts of 1924 and 1926, the material parts of which are substantially the same as the provisions of the Revenue Act of 1934 here under consideration. The facts were that the trustees in 1921 made a declaration of trust of real estate, reserving the powers to purchase, encumber, sell, lease, and operate the property; to construct and operate golf courses, club houses, etc.; receive the rents, profits, and income; make loans and investments; make regulations; and generally manage the trust estate as if they were the absolute owners. There was no provision for current or periodical distribution of income to the beneficiaries.

After platting some of its land, selling lots, and constructing a golf course and club house, the *Morrissey* trust sold the property to a corporation for stock, but continued to operate it under lease until January, 1924. In the taxable years, its activities consisted of collecting installments of principal and interest on contracts of purchase, the receipt of interest on bank accounts and of fees on assignments by the holders of purchase contracts, the execution of conveyances to purchasers, the receipt of dividends on the stock of the incorporated club, and the distribution of moneys to its beneficiaries. The

trustees held from 16 to 29 per cent of the beneficial certificates.

The Court held that the *Morrissey* trust was an association taxable as a corporation. It said:

> "'Association' implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, *an enterprise for the transaction of business.*"

The owners of petitioner's beneficial interests did not "associate" themselves as conductors of a joint business enterprise. At the time of the creation of the trust, petitioner's trustees did not know who would become beneficiaries, and had no form of association with them. The trustees themselves did not purchase or own beneficial units. The certificate holders had nothing to do with the planning and creation of the trust, since it was formed before they purchased their shares. They were ignorant of the identity of the other certificate holders. (R. 62–65.) These facts negative any thought that there was a voluntary "association" between and among the certificate holders and the trustees.

Petitioner acquired a minority interest in an oil and gas lease which already had five producing wells which were being operated by the Westgate Oil Company under an operating agreement with the lessor. The oil and gas were sold directly to the pipe line companies by the Westgate Oil Company. (R. 62.) Petitioner acquired the right to receive its proportionate share of the proceeds from the sale of oil and gas, after its proportionate part of the expenses was deducted. It had no voice in the management or operation of the lease and could not say to whom the oil should be sold. It had only the right to see that its share of the proceeds was not dissipated. (R. 66.)

A statement of some of the activities which petitioner *did not* and *could not* do under the trust instrument serves to show that it did not carry on a business. Petitioner did not buy or sell property; it did not reinvest the proceeds from oil and gas sales; it did not drill any wells and did not own any drilling

machinery; it did not receive oil and gas as such and then resell it; it did not perform any act which entailed the exercise of business judgment in connection with the property in which it had an interest (App. 62–66). No power is given the trustees to purchase property; to sell trust property, unless they had the consent of two-thirds of the beneficiaries; to reinvest funds in their possession; to borrow money or make notes; to mortgage property; to make or renew leases; to repair, improve, or develop property. They were obliged to distribute all moneys which came into their possession, and could retain nothing except an amount to cover current expenses. Since they were without power to acquire any additional property, the powers given by the trust instrument could be exercised only with respect to the property conveyed by that instrument, and by the terms of the conveyance they had no voice in its management.

The mere collection and distribution of income, after paying the necessary carrying charges, does not constitute the carrying on of a business. *McCoach* v. *Minehill Rd. Co.*, 228 U. S. 295; *U. S.* v. *Emery, Bird, Thayer Realty Company*, 237 U. S. 28; *Higgins* v. *Com.*, 312 U. S. 212; *City Bank Farmers Trust Co.* v. *Com.*, 313 U. S. 121; *The Cleveland Trust Co., et al.* v. *Com.*, 115 F. 2d 481 (C.C.A., 6th).

It is well established that the owning of a *royalty* interest in an oil and gas property does not alone constitute the carrying on of a business. There is no difference between a royalty interest and a minority right to a share of the net proceeds from the working interest (the lessee's interest), when the owner of the interest has no voice in the management and operation of the lease, but simply receives a share of the net proceeds after the expenses of producing are paid. Such an interest is referred to as an over-riding royalty and such was petitioner's interest in the Westgate-Carey lease.

It has been shown that petitioner possessed only the right to receive a share of the proceeds from the oil and gas sales from the Westgate-Carey lease, after expenses were paid. The Westgate Oil Company did not operate the property as

agent for petitioner because petitioner had no control whatever over that company. (R. 66.)

The Board held, however (R. 27), that the Westgate Oil Company operated the lease for petitioner to the extent of petitioner's interest in the proceeds therefrom, and cited *Helvering* v. *Combs*, 296 U. S. 365. In that case the trustees acquired the whole interest in the lease except 8.5% of the oil and gas reserved by the lessor. An agreement was made with one Bailes to furnish some of the equipment and materials and to superintend the drilling of a well in return for 12% of the production. The trust paid for labor and materials not provided by Bailes. By that agreement the trustees employed Bailes as superintendent to do the drilling but he was under their direction and control. In effect they performed the drilling. That case furnishes no authority for the holding that the Westgate Oil Company operated the property for petitioner.

Thus it appears that petitioner was not an association and was not doing business, and therefore is not taxable as a corporation under the decisions of this Court.

## CONCLUSION.

In view of the foregoing it is respectfully requested that the writ of certiorari be granted.

Respectfully submitted,

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